RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 16, 1987 **LETTER 980**

Dec. 4 DJIA 1766.74; PTI 2599; A-D Ratio -13.71
Dec. 11 DJIA 1867.04; PTI 2607; A-D Ratio -13.18
Current Dow Yield: 3.69%; Dow P/E: 14.8

THE MARKETS. The patterns on my charts are pretty much uniform. What do they show? They show a picture of a major bear market that has been destroying the wealth of America. The Wilshire 5000 Index is figured in dollars, and it is accepted as providing the dollar-value of most of corporate America. At its 1987 high the Wilshire had a value of $3.29 trillion. By last week the Wilshire had dropped to $2.28 trillion, showing a loss of $1.01 trillion. Now I don't care how much the Fed would like to pump into the economy, they're not going to make up for that kind of loss (actually, the rate-of-change in the money supply, after surging for a few weeks after the crash, has been dropping ever since).

The week of December 4 ended with the Dow losing ground for the fifth straight week and eight out of the last nine weeks! December 4 also saw the Dow (at 1747.35) an astounding 26% below its 200-day moving average. In the face of that kind of crushing performance, the market was literally screaming, "Give me a break." The break came last week with the Dow and most of the Averages finally posting gains (although breadth lagged on the rally).

But let's go back a bit. During the week ending December 4 we saw new bear market lows in the following: the D-J Transport Average, the D-J 65 Stock Composite, the NYSE Industrials, Transports, Financials, and Composite plus the S&P 500, Transports, Financials, and Industrials plus the Amex, the Wilshire, and the NASDAQ. Finally, we saw new bear market lows in my PTI and DowPow and in the A-D ratios in all the exchanges. It was a picture of new bear market lows across the board with the exception of the Dow and the various utility averages.

On December 4 the D-J Transportation Average broke below its October (crash) low of 674.92 (see page 1 chart). The D-J Industrials Average did not confirm (a downside confirmation would have entailed the Dow breaking below 1738.74). In the face of this non-confirmation, the Dow and the rest of the market rallied, although breadth on the rally was not exactly overwhelming.

For the **near term**, the picture boils down to two critical sets of figures (see page 1 chart). On the upside we have the October rally highs of 2027.85 (Industrials) and 787.01 (Transports). If the secondary trend of the market is to turn decisively up, those two levels will have to be bettered.

On the downside we have the October low of 1738.84 (Industrials) and the December low of 661.00 (Transports). A breaking of those two points would be the signal for a resumption of the primary bear trend.

All the action of the Averages between those two points is probably going to be puzzling and frustrating. I might remind subscribers that bear market rallies can look deceptively good -- often better than the real thing (i.e., better than bull market advances).

My Primary Trend Index (PTI) formed a major top and has since been in a steady and persistent decline (page 2 chart). The bearish mode on the part of my "fail-safe" indicator is telling us to "get on the sidelines." Veteran subscribers and I have learned not to argue with the PTI -- it can be expensive.

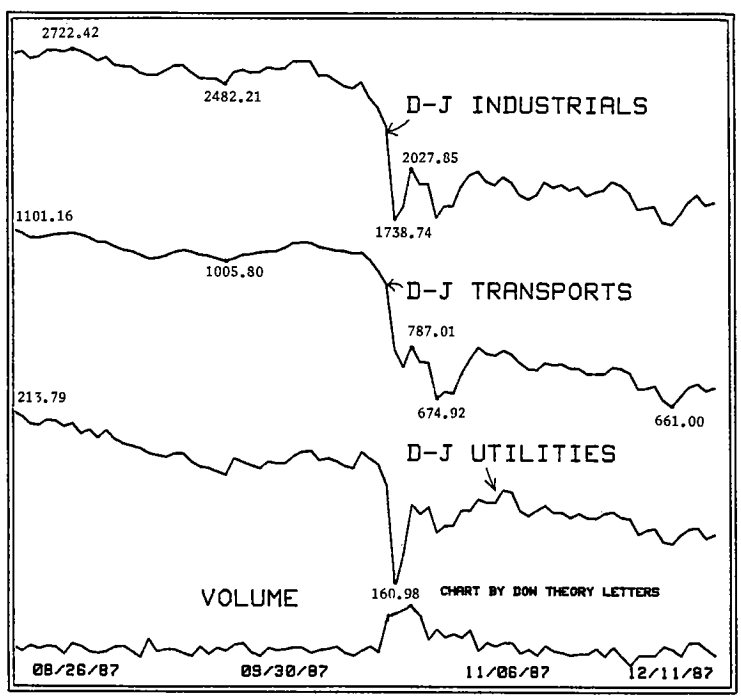
The advance-decline ratio tracks the advancing or declining tendencies of the majority of stocks on the NYSE. In examining the market picture, I find it helpful to equate the A-D ratio to the water in a bathtub and the Dow to a bar of soap bobbing up and down in the water. If the water line (A-D) sinks relentlessly, it's going to take the soap and everything else with it. So far in this bear market (see page 2 chart) that's what has been happening.

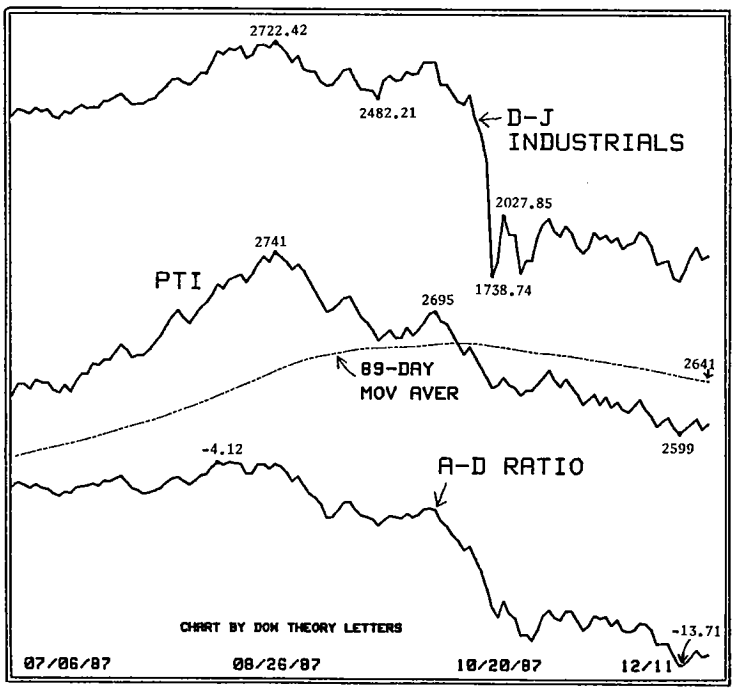
This is a point for technicians to remember: It's characteristic of powerful bear markets to work off over-sold conditions by moving generally sideways over a period of time. Once the over-sold condition is neutralized or worked off, the market is ready to go down again.

THE BIG PICTURE: In all the years I've been in this business (and it's adding up to more years than I like to think about), I don't think I've met more than half a dozen people who I believe are truly expert in interpreting Dow Theory. In order to fully understand the Theory, I feel it is necessary to read and become fully familiar with the writings of Charles H. Dow, William Hamilton, Robert Rhea, and George Schaefer. I also believe it is necessary to have operated through at least one (and preferably two) complete bull and bear cycles. That sounds like a lot to ask. And it is, but that's what I think.

True, I've met a lot of people who are familiar with a piece of Dow Theory -- almost always the mechanical part which deals with the pattern of the Averages and with bull and bear signals. But even in this area I see many mis-applications. and mis-interpretations.

However, Dow's Theory comprises much more than simple mechanical bull and bear signals. The Theory entails a knowledge of stock market history, the various psychological phases, yields, crowd sentiment, the meanings of confirmations and non-confirmations, moving averages, a thorough understanding of the three trends (primary, secondary, and minor) -- and above all, a knowledge of VALUES and their application to Dow Theory.





In the last two Letters I discussed the three psychological phases of a bear market. I noted that in the first phase the market goes down for no reason apparent in the economy. It's as if in the midst of rosy economic conditions, the market suddenly falls apart. In this bear market, the first phase is represented by the action since the August 25 high in the Dow. From the August high, for no reason that any of our brilliant economists can come up with, the market turned decisively down. Two months later it crashed in an explosion heard around the world.

Note: Actually, from a Dow Theory standpoint, the writing was on the wall well before either the actual bear signal or the crash. For instance, back in **Letter 974 (Sept 23)** I wrote, *"Let me introduce a thought that has occurred to me. If (in a month or so from now) it turns out that we are in a bear market I would be able to look back and say the following: 'You know, August and September 1987 presented the perfect picture of a market top, and I honestly don't know how anyone could have missed it'.*

"After all, yields on the major stock averages were at historic lows. Price/earnings ratios were high. Book values were absurdly high. Volume on the NYSE was huge. In the face of all that, nobody even mentioned the possibility of a bear market being in force (although a number of analysts did concede the possibility of 'a correction'). On top of that current gurus were saying that 'stocks are going a lot higher because our market is cheap compared with the Japanese market'.

"Wait, there's more -- looking back we note that the Utility Average topped out on January 22, the A-D ratio topped out on March 25, and following the Transport high the Dow advanced to an unconfirmed new high of 2722.42 on August 25. All in all, it was an ideal picture of a major market top. And yet the great majority of investors and professionals remained bullish and optimistic throughout the whole sequence."

That's what I wrote in late-September. Let me add that I'm not including the above as a boast or as a sop to new subscribers. The reason I included the above italicized section is to refute those who claim that Dow's Theory tells you the story afterwards -- when it's too late to act.

Example: I have great respect for my friend, Gerry Weiss, who publishes the excellent *Investment Quality Trends* out of La Jolla, but in her latest report she writes, *"The Dow Theory has re-proved its validity and its importance to investors. Although it failed to get stockholders out of the market at the top of the trend on August 25th, it did flash a major bear market signal on October 15, 500 points off the top, but four days before the crash, sparing investors another 500 point loss."*

My Answer: "C'mon Gerry, you've been reading my reports for many years. You read my "Special Report" of December 20, 1974 (mailed a month before the actual January 27 bull signal) in which I stated that based on Dow Theory precepts it was time to buy stocks -- even though a mechancal Dow Theory bull signal had not yet been rendered. And you read my Letters during September and October of this year in which I stated that I, personally, had sold out of the great bull market even though a mechancial Dow Theory bear signal in the Averages had not yet appeared.

I'm writing all the above because I want to emphasize to subscribers that the Dow Theory entails a great many considerations, and a mechanical bull or bear configuration in the Averages is just one of them. Furthermore, there is nothing in Dow's Theory that even remotely suggests waiting for a bull or bear configuration in the Averages before buying or selling. Bull and bear signals simply confirm that the actions that we have taken were correct.

All right, back to the present. The first (psychological) phase of the bear market is now well underway. But at this time, many "experts" are still insisting that the crash was a mistake based on computer program selling or portfolio insurance selling. Nevertheless, the first hints of economic contraction are now surfacing, and I suspect (obviously I can't prove it yet) that the nation is already moving into recession.

If so, we could be nearing the second (psychological) phase of the bear market. This is the phase in which stocks go down as they reflect obvious and visible signs of deterioration in the economy as well as evidence of declines in corporate earnings (by the way, the psychological phases of bull and bear markets are not necessarily linked to the price movements).

It's early, but the hints of trouble are beginning to show in the economy. For instance, auto sales are sluggish with layoffs appearing (GM has shut down a few plants and VW just shut down its entire US manufacturing facilities). Retail sales are dull, despite a rash of cuts, discounts, and well-advertised sales that have all come weeks before Christmas. Perhaps most ominous (because Americans have most of their assets tied up here), the housing market has turned sloppy, with the prices of both new houses and new home sales (and the number of new home starts) all down in October (third quarter housing starts were down 13%). As I said, I can't prove it, but I suspect that a recession is already underway.

Question: Russell, if a recession has already started wouldn't this be a good time to start buying stocks? I've heard that in the past the market started up at just around the time that recessions became apparent.

Answer: My instinct tells me that this is not going to be comparable to what we've experienced in the recent past. This is a major primary bear market, and I believe the economic contraction is just beginning. The fooler here, in my opinion, will be how severe this economic contraction is fated to be, how world-wide it's fated to be, how long it's going to last, and how immune it's going to be to government (Fed) manipulations.

In other words (and I'm going to be blunt), I think that all we're seeing now in the economy are the early hints of big trouble. Consider this: During October we witnessed the greatest trend change (in extent) in stock market history confirmed with the greatest single day of volume in history. As I interpret it, the NYSE has told us in no uncertain terms that we are going to be facing hard times -- VERY hard times.

Somewhere ahead the economic news will begin to turn obviously bad -- at that time we will be entering the second phase of the bear market. The second phase is traditionally the longest phase; it could

last a year or a few years or even longer. Furthermore, the second phase of a bear market is the most deceptive phase with many tricky and violent (upward) reactions, sudden collapses, and unexpected turns.

As I see it, the second phase of this bear market (and it may be many months before it arrives) is going to entail severe hardships for individuals, for corporations, and for the nation. Remember, this country has been living over its head for decades. At the same time it has been pussyfooting, deceiving itself, and lying to itself -- all the while building up monstrous and unsustainable debts and deficits.

The bear market, in a way, can be titled, "Reality Time comes to America." What kind of reality? For decades Americans have been getting a dollar's worth of perks for 75 cents. And for many years our politicians have been thinking and acting as if 2 plus 2 equals 5. The bear market will be telling the American people and its election-obsessed politicians that 2 plus 2 still equals 4 -- in no uncertain terms.

Question: Russell, you often sound like some kind of 18th-century religious moralist. Do you really believe this bear market is going to be that bad?

Answer: I don't want to sound like a moralist and I don't want to sound like the "Wrath of God," but I do want my subscribers to realize that what's coming up is not going to be fun. I honestly don't think I'm exaggerating when I say that this is going to be a big, costly, painful bear market. I am simply telling my subscribers what I sincerely believe lies ahead. You, as a subscriber, paid your hard-earned money to receive Dow Theory Letters. For me to take your money and then somehow tone down my real views would be cheating you -- failing to give you what you've paid for.

When I say to "buy the market" or "sell your stocks" I know from experience that about one-third of my subscribers will take immediate decisive action, another third will take partial action, and a final third will wait "to see if Russell is going to be right this time." In general, people move on their emotions in this business, not on their brains. Therefore, when I want people to buy in a bull market or sell out in a bear market, I have to hit hard -- on their emotions as well as their brains. That ain't easy, but I feel I must do it or I'm not doing my duty for my subscribers. Let me put it another way -- God gave me the ability to write, and I use that ability to its utmost.

Question: Why don't you recommend trading this market? After all, there will be big rallies in this bear market.

Answer: In general, people tend to get killed trading bear markets. I'm aware that a lot of subscribers have been waiting for the big upside correction that I've written about. But there is still an awful lot of stock out there to be sold. A great many pension funds, institutions, mutual funds, and individuals have been caught in this bear market. They're still loaded with stocks and they're waiting impatiently for a rally. I doubt if the bear is going to accommodate them; I doubt if he's going to let them off the hook that easily.

Sure, we'll get a big upside correction. But it looks as if it could come from lower levels. When the time comes, I hope to be able to identify the first important bottom. And at that time I may (or I may not) suggest some buying for a bear market recovery. We'll see, but far more important than scalping bear market profits is the need to get out of the way of the bear. Rememer this -- the market is always there, but the same is not necessarily true of your capital.

Question: How do you hope to identify the ultimate bear market bottom?

Answer: I'll try to do it in the same way that I identified the 1974 bear market bottom. But I'm not kidding myself. Each bull market and bear market is different, and sometimes intuition and experience will do what no amount of textbook study and mechanical procedure can do. So I could sit down and list the various techniques that I will be using, but I feel that this would be a waste of time this early in the game.

I can tell you about one area that I will be watching and that is the area of values. Because this is a major bear market, I expect it to end with investment-grade stocks selling at great bargain levels with the average yield on the Dow at around 6% and perhaps much more.

This will take time. If the Dow were to drop to a level which produced 6% yields right now, it would have to sink to the middle 1100s (although dividends will be cut as this bear market moves along).

Question: Russell, what worries you most about this bear market?

Answer: I think it's the question of "where's the safety this time?" Each big bear market develops its own way of busting investors. In the 1930s it was a case of nobody having any money. There was never a question of the value of the dollar then -- it was a question of who had any dollars.

This time it may be a question of "what's the dollar worth?" Don't forget, we are the nation with the world's reserve currency, and yet we have been willingly debasing our currency. Many nations hold huge amounts of dollars. If they lose faith in the dollar and "want out," the result could be unbelievably disastrous.

I don't know any perfect solution to the problem of what to do if the dollar becomes an unwanted currency. I've advised a policy of diversifying via systematic monthly purchases of gold bullion coins. I've followed this policy myself, and I've also been buying some high-grade diamonds, but the latter could be a risky policy for the average subscriber because (1) diamond prices could decline if deflation enters the picture, and (2) the average person does not have the vaguest idea of how to buy diamonds without getting scalped on both quality and price.

Question: I own a few stocks that have actually been increasing their earnings since the crash. Should I hold onto them?

Answer: I wouldn't. What kills stockhoders in a bear market is not necessarily declining earnings in stocks. What kills them is the decline in price/earnings ratios (what investors are willing to pay for earnings). Consider this: Your stock's earnings rise throughout the bear market -- from $2 a share to $2.50. But average P/E ratios drop from 20 near the beginning of the bear market to 6 near the end of the bear market. What happens to the price of your stock? You tell me!

INVESTMENT POSITION: Have you noticed that 85% of all the columns and comments from the pros have to do with what stocks you might or should be buying now that "bargain time" is here? Have you wondered why so few pros talk about assuming a true defensive position? Have you pondered why so few advisories suggest holding large quantities of defensive items and cash?

The reason is obvious: Wall Street doesn't run by holding cash, it runs by selling stocks. Branch managers of brokerage houses don't ask their brokers, "How did your customers do during October to December?" Hardly. They ask, "How was your gross during October to December?"

So it remains for me to tell you that (regardless of impressive rallies and upside corrections), this is **still a bear market,** and in a bear market the odds are stacked against your making money on the long side of the market. It's boring, it's uninspiring, it's a rotten shame, but the bear rules this box. That means that we think in terms of (yawn) cash, T-bills, muni cash funds, high-grade bonds, bullion gold coins, and maybe even foreign currencies (for the latter you might call *International Gash Portfolios* at 1-800-232-3310 or 1-800-82- 0188).

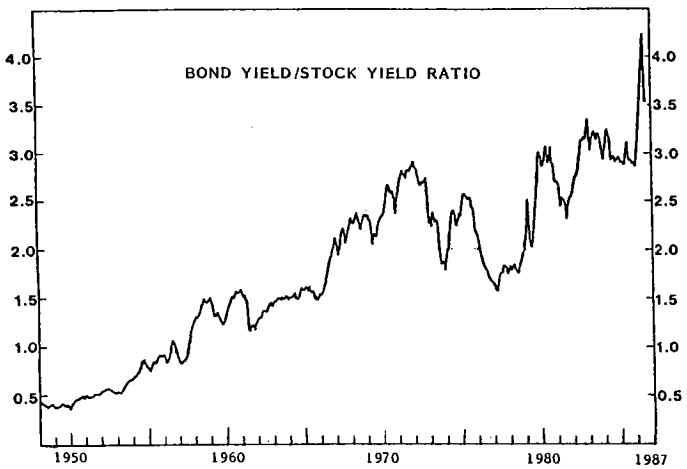
VALUES: There are any number of methods of determining values. As far as stocks are concerned, Charles H. Dow preferred the simple dividend yield method, and in truth Dow's observations have held up remarkably through the years. Dow wrote: "When a

stock sells at a price which returns only 3.5% on the investment, it is obviously dear, except there be some special reason for the established price. . . . The tendency of stocks over a considerable length of time will always be towards value."

A study of the yield cycle of the Dow demonstrates that throughout history when the Dow provides a yield of around 3% it is in a top area whereas when the Dow yields 6% or more it is in a bottom area. This is obviously not a pinpoint gauge. For instance, the Dow yield went to an incredibly low 2.56% in 1987 two months before the crash. And back in 1932 during the depths of the worst depression in history the yield on the Dow rose to 10.1%. That period provided great values that have never been seen since.

As subscribers know, I continue to use those classic Dow-yield gauges of value. But there is another important measurement which I follow. It's the comparison of stock yields (which are more speculative and certainly adjustable) with bond yields (which are relatively safe in that they are fixed and they are guaranteed).

Back in Letter 968 (July 1, 1987) I published a chart of the stock/bond return ratio (i.e., stock dividends divided by bond interest). My comment at the time was, "The ratio is now at its highest level since 1981 and equal to the highest level in 20 years. This very high ratio tells me that the ODDS now favor the total return on bonds outperforming the total return on stocks -- at least into the foreseeable future."



Ah yes, and three months later that prediction came true. But during the two months following my Letter 968 comments, the ratio spiked up to an incredible 4.5 to 1 in favor of bonds. From there -- came the crash.

I am indebted to Paul Macrea Montgomery of *Legg Mason Wood Walker Inc.* for this chart which traces the bond yield/stock yield ratio from 1949 to the present. The chart shows the dramatic final spearpoint top at the 4.5 level --and the downward plunge from the high.

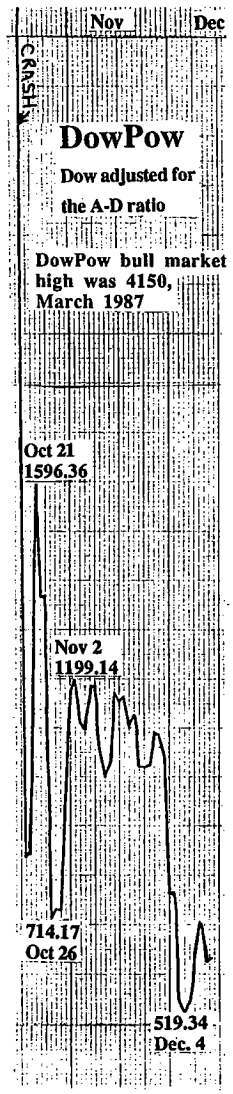
Where do we go from here? As Paul noted in a recent speech, following the 1929 crash and during the Depression years there was a decided preference for bond income. Stocks were distrusted as were their dividends. But following WW II the nation experienced a long period of inflation, and it was during this period that stock income was increasingly preferred to bond income (the latter, of course, could not adjust itself to inflation).

It is my opinion that the preference for inflation-adjustable stock income over bond income ended with the crash of 1987. Notes Paul Montgomery: "The reversal in the bond/stock yield ratio occurred coincident with a record decline in stock prices, a record rise in bond prices, record volume in both markets, and record drop in the ratio itself. It is a technical rule-of-thumb that when record price and volume accompany a turn, that turn is likely not a mere correction, but part of a new trend. Thus the probabilities suggest that we have seen the peak of investor preference for stocks over bonds." So says Paul Macrae Montgomery. Richard Russell agrees.

DOWPOW is my proprietary Index of the Dow adjusted for the action of the advance-decline ratio. I believe that DowPow is particularly useful in this area in showing us what has really been happening during the post-crash market.

The two-day bounce off the Oct. 19 crash low took DowPow to an Oct. 21 peak of 1596.36. DowPow then plunged to an Oct. 26 low lof 714.17. Another rally took DowPow to a Nov. 2 peak of 1199.14 (well below the Oct. 21 peak). Most recently, on Dec. 4, DowPow broke to a new bear market low of 519.34.

What is DowPow telling us? It is telling us that the action on declining days has been more powerful than the action on advancing days. Thus, when the Dow is adjusted for breadth, we have a picture of declining tops and declining bottoms. This is basically a picture of distribution, and it is a bearish picture. I don't think any other market measurement shows the picture quite as clearly.



THE LITTLE THINGS: I grew up in New York City, right in the center of Manhattan (on East 89th St.). One day when I was 15 years of age my father and I went shopping in Woolworths (in those days it really was the "five and dime"). I wanted "a present" so after a long search my dad bought me a cactus plant. That spiny little plant fascinated me. I placed it in the window of our New York apartment and watched it grow. The more I studied it the more I was engrossed by it. I guess that cactus represented something exotic, something mysterious, something from another world far from the City. Then, wonders of wonders, that cactus produced a beautiful red flower. I was beside myself. It seemed a miracle.

I asked my father about the plant, and he said he would buy me a book that would tell me all about cacti. The next day Dad came home with a little volume entitled "Our Native Cacti" by Ethyl Bailey Higgens (I remember that name and title as if it were yesterday). I was enthralled with that book. I studied it for days. I learned all the scientific names of the various cacti pictured in the book.

Then I began going up to the New York Botanical Gardens (a long ride on the subway) to study their (then) huge collection of cacti. After a few trips I got friendly with some of the curators and botanists at the Gardens, including the taxonomist (he classifies the plants), a gruff, bear of a fellow named Ed Alexander. Ed took an interest in me, and he told me all about the wonders of California, a place where you could plop anything in the ground, and it would grow.

What was a city boy doing -- mouthing long Latin cactus names (like Echinopsis multiplex, Cereus peruvianus) and dreaming of growing strange and exotic plants in a world he had never even seen? Maybe my interest in cacti was an escape, a fantasy which shielded me from the difficulties and harshness of the city. Maybe it was just an obsession with the exotic, the unknown. I bought many more more cacti, but I became increasingly frustrated with the difficulty of growing these plants in a steam-heated apartment in grey, dusty NYC.

I began writing to cactus nurseries in California asking for their catalogues. Four cactus nurseries were located in San Diego in those days. I looked longingly through the nursery catalogues filled with strange, Latin names. How I studied those catalogues, and gad how I longed to have a big cactus collection of my own. And all the while I kept thinking of how wonderful it would be to live in California, land of sun and xerophytes.

Time went by. I spent a year at Rutgers. I enlisted after my freshman year. I went off to war. I survived combat. I returned. I finished up college under the GI Bill at NYU. I got married. I had kids. But in the back of my mind I still longed to move to California -- and grow cacti. My life–long obsession never left me. It was a strange, relentless obsession. It was a dream.

In 1956 my father died. The next year, in 1957, I started Dow Theory Letters. I had, for many years, studied the stock market with the same passion and obsessiveness with which I had studied cacti. As my new business grew and expanded I realized that it was also a totally portable business.

I had three kids at the time (I now have five). One of the kids was autistic, and every winter she would get dreadful, lingering, tortuous colds. I used those colds as the final rationale. "Nicky's colds are too much for her or us to bear. I can't take another winter in New York. Let's pack up and move to San Diego." My wife agreed, and that's exactly what we did. The furniture, the typewriters, the files, it was all packed into one huge truck. And we were off to the Golden West, to the other side of the continent.

One thing that worried me was that at that time almost all market advisors lived in NYC. Could someone write a market letter from California, where the Wall Street Journal came through the mail four days late and Barron's arrived even later? I knew that Robert Rhea, the great Dow Theorist of the 1930s, had written his reports from Colorado Springs. If he could do it, I told myself, I could do it. That settled it in my mind. We made the big move in 1961, and I've never regretted that move for a second.

I think now and then of that first little cactus plant that I bought in Woolworths and that book my father gave me back in 1939. It's hard to believe, but those simple little acts changed my life -- put me on a path I might never have taken otherwise. Sometimes I think of those events when I talk to my two younger kids. What might they be thinking or doing that could set their lives on a certain path? Life is strange and fascinating -- as is the human mind. Can a 10-cent Woolworth cactus point a man in a certain direction? It did with me.

NOTES & QUOTES: The bonds have been walking a tightrope between pressure for higher rates (due to a falling dollar and horrendous, unending trade and budget deficits) and pressure for lower rates (which could be brought on by a 1988 recession). The wild card in the interest rate picture (as the bear market continues) -- an interest rate spike brought on by illiquidity and a rush for cash to stay solvent.

* *

My greatest single frustration since the crash is in not being able to personally answer the dozens and dozens of letters that have arrived here. Most of these are "thank yous" for my efforts in getting subscribers out of the market prior to October 19 -- plus questions, questions, more questions. There's no way I can answer all these letters -- I just don't have the energy. If I did answer them I wouldn't have the energy to do the work and the reading that is required to turn out Dow Theory Letters. But rest assured that I carefully read each and every letter.

* *

Many of the letters received here are personal, fascinating, wonderful and some are heart-rending. Here's an example: "Dear Mr. Russell, I'm a commercial airline pilot. I invested all of my saving in stocks, warrant and index options. I got killed on Black Monday. I lost it all and more (margin). I'm 38 years old. I guess I can start over. I had subscribed to P..... and MH..... I originally received your Letter via a $1 trial in Barron's. I remember showing your Letter to my wife in September and laughed it off as some old 'cob-web Dow Theory geezer'. I told her I wouldn't waste my $225 on a dinosaur! Well sir, here is my $225. Sorry for the delay. And I must confess, my wife lent me the money -- because I don't have any. Best regards, T.V., Quebec."

* *

Mark Russell (no relation), the comedian, says that the two most popular forms of exercise here in Southern California are "jogging and helping divorced friends move." Now that's downright cynical, but it could just be true.

* *

I continue to believe that the curse of America is the professional politician. The Founding Fathers never thought in terms of political dynasties where politicians put their re-election before anything and everything else. So instead of getting statesmen, we get toadies who live via the popularity poll or the public's wish-list. These politicians don't do what's best for the nation, they do whatever they think will get them re-elected.

* *

But, you argue, the people elect the politicians, and therefore the people get what the voted for. That's true. And that may be the fatal flaw in the theory of Democracy. The finest course I ever took in college was Professor Sidney Hook's "Philosophy of Democracy." "A democracy," said Hook, "is a system that entitles the people to make their own mistakes." True, and we're making them. A good democracy demands an informed electorate. Electorates are people, and people learn (gain) through pain. That may be what this bear market is all about.

* *

I just got the new (January) *Car and Driver,* and this is their annual "ten best cars" issue. Of the 10 best, no less than five were Hondas, including the Acura Integra, the Acura Legend coupe, the Honda Accord, Civic and CRX. Others that made the top 10 are Chevy's Corvette, the Audi 5000, Ford Mustang 5.0, Ford Taurus, Saab 9000 Turbo. In another category, acceleration, the Buick GNX came in first. In the quarter mile the Buick GNX (believe it or not) tied with the Porsche 912 turbo doing the quarter in 13.5 seconds and both hitting 102 MPH. For top EPA city fuel economy the Ford Festiva LX won the honors.

* *

What movies did the Russian embassy order when Gorbachev came to town? Three: "Platoon," "Top Gun," and the new "Nuts."

* *

HBO just showed "Godfather" and "Godfather II." To my mind they are two of the best, and most engrossing American movies ever made. There are very few films that I can watch three and four times -- and both of these are in that category.

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The crash, as I've been saying, is basically a deflationary event. It's deflationary because billions of dollars were wiped out. As far as inflation is concerned, I think it's a wasted worry. The real worry is deflation. Because the crash had a negative effect on the majority of Americans, we will soon see (in my opinion) money velocity turning down. This means that the Fed will have to inject more money into the sytem to offset declining velocity. If the Fed fails to do this, the situation will be even more negative than it is now

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I view the bear market as basically deflationary, but there remains the complication of the falling dollar (which contains inflationary implications). This plus the danger of an unraveling of the banking system are the arguments for holding gold.

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My good friend Marty Zweig tends to be a worrier, but in today's market I feel his worrying is fully justified. Marty is an excellent

market historian, and in his report of Nov. 20 he notes that the Dow dropped 36.1% from its high to the crash low. Since 1885, he notes, there have been 11 other instances of declines of 30% or more, and he adds, "In every single case the economy entered a recession or a depression. Indeed, only three times, 1899-1900, 1969-70, 1973-74 were we lucky enough to have 'only' a recession. The rest generated depressions of varying degrees, including the bear markets of 1895-97, 1901-03, 1906-07, 1919-21, 1929-32, 1932-33, 1937-38. It's an ominous record, yet most economists are ignoring it! Then again, the same was true in late 1929 when the economists minimized the economic damage of the crash. Many think that share ownership is not widespread enough today to causes a recession. Well, it's wider by far than it was in those 11 other cases, when the big market declines wrecked the economy."

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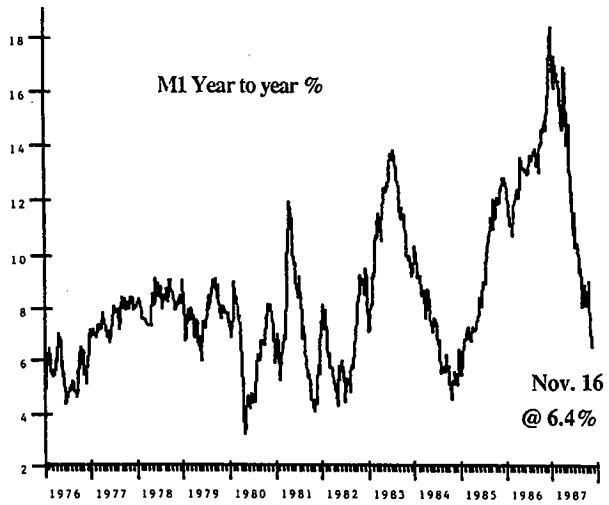
Strange things are happening: This chart (courtesy Ed Hyman of CJ Lawrence) shows that despite the crash and bear market the year-to-year trend of the M-1 money supply continues down. Says Ed, "The Fed has drained all the reserves they had injected following the crash. Indeed, total reserves are now below their pre-crash level!" Russell comment: This is not good. It may suggest that the Fed is more worried about the dollar than it is about the economy, but if this monetary contraction continues, look for -- trouble.



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Enough nonsense, what do the **massive US trade deficits** really mean? The way we are going, this nation's external debt could mount to $1 trillion by 1990, equal to the foreign debt of ALL other nations combined. This huge and climbing debt must be serviced. At 8% we're talking about shipping $80 billion a year out of the US just to service our crazy debt. Obviously, this can't go on -- there's got to be a breaking point. In the meantime, the risks entail climbing interest rates, higher taxes, credit stringency, government spending cuts, higher unemployment, a continuously sliding dollar and ultimately an economic collapse.

Classically, the reaction to the US deficits would be a depression, a depression that would lower US wages and kill US consumption (including, of course, imports). To stave off that kind of situation (and to keep our lofty standard of living) the US continues to sell foreigners our greatest export -- debt. The breaking point comes when we can't sell the debt, at which time the dollar collapses, interest rates rise, business caves in and who knows -- a classical depression could enter the picture again.

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Outstanding analysts in this business are few and far between. Many of the best pioneers such as Garfield Drew, Justin Barbour, and Edson Gould never got anything like the credit they deserved. Last week John Brown from Houston sent me the sad news that George Lindsay had died at the age of 82. Lindsay was a brilliant stock market analyst (he published Lindsay's "Opinions"), an absolutely honest man who made many brilliant market calls.

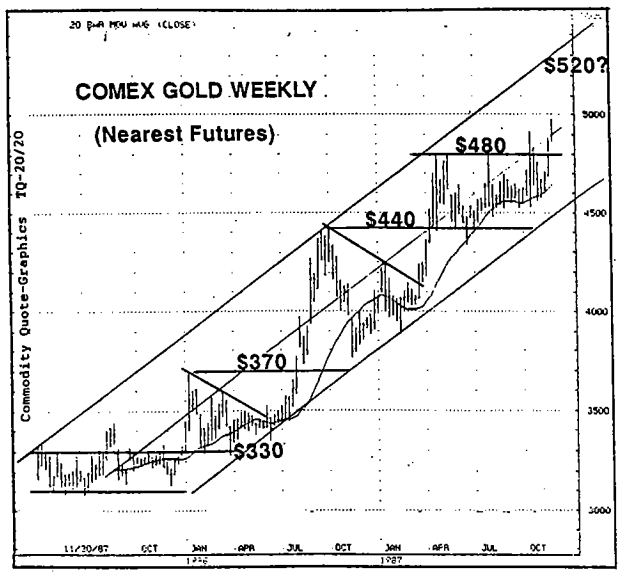
In a final letter to Brown dated July 1, Lindsay writes: "Sorry I'm having trouble sending you any material. I am 82 years old, have been sick for 3 years and am feeling worse every day. You mentioned my strong voice. It has fooled others as well, including my doctors. ... You see the number of calender days in the basic advances. The present advance should last between 934 and 968 days. You start counting it at one of the last lows of 1984 or the first one in 1985. ... It now seems likely that the last high will come some time in August 1987. I'm sorry but this is about all I can do in my present condition. Sincerely, George Lindsay."

Russell Comment: "Brilliant to the end," that is my obituary for George Lindsay.

GOLD: Sometimes a chart says it all. In the last Letter I included a chart showing the continuing bull market in gold, a bull market which started in February 1985. This week's chart is courtesy of my old friend, Ian McAvity, *Deliberations*, (PO Box 182, Adelaide St. Sta., Toronto, Canada M5C 2J1 (whew, those Canadian addresses, no wonder they don't get their mail!).

As you can see, gold has been moving up and up, each rise consolidated and corrected prior to the next step up. This is the kind of subtle, deceptive action that can end with an explosion as it finally dawns on the "outside world" what's really happening. And what's really happening is that gold is under accumulation -- steady, persistent, powerful accumulation.

On the floor of the NYFE the brokers wear little badges that say, "The trend is your friend." It's certainly always been a friend of mine. The only problem, of course, is figuring the direction of the trend. In gold it's up, so my advice still stands: Continue to accumulate those bullion gold coins on a monthly basis, and buy 'em in approximate fixed dollar amount. So far, this process has been working, and with a minimum of scares, sleepless nights, and sweaty palms. On Monday (Dec. 14) the London fix surged to 502, highest level since early-1981.



NEXT MAILING: Dec. 30

By the way, my long-time disinterest in silver seems to be justified. The gold-to-silver ratio closed the week ending Dec. 11 at 71.9, a powerful vote for gold as opposed to silver.

LATE NOTES: First, **holiday greetings** to all my brave subscribers, be you Christians, Buddhists, Jews, Jains, Mohammedans, Moslems or whatever (and believe, me, we've got 'em all).

As to my final observations on the market, the Dow was up a record 100.30 points for the week ending Dec. 12. But the Transports are now lagging noticeably and my PTI was up only a measly eight points on the week (DowPow is also lagging dramatically). For the secondary trend to turn bullish, the Dow will have to better 2027.85 confirmed with a Transports rise above 787.01.